

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In Re: Investigation into) DOCKET NO. 860001-EI-G
Affiliated Cost-Plus Fuel Supply) ORDER NO. PSC-92-0347-FOF-EI
Relationships of Florida Power) ISSUED: 05/13/92
Corporation.)
_____)

The following Commissioners participated in the disposition of this matter:

SUSAN F. CLARK
J. TERRY DEASON
BETTY EASLEY

FINAL ORDER

BY THE COMMISSION:

Prior to the February 1989 hearing in Docket No. 900001-EI, the Office of Public Counsel (OPC) raised the issue of whether it is appropriate for Florida Power Corporation (FPC) to recover fuel procurement costs and a return on equity charged by Electric Fuels Corporation (EFC) or any other affiliates. The hearing on this issue was deferred until the August 1989 hearing in Docket No. 900001-EI. Thereafter, the Commission deferred its decision pending the establishment of a market pricing methodology in Docket No. 860001-EI-G. On January 10, 1990, the Commission issued Order No. 22401, in which it was determined that FPC is entitled to recover a reasonable rate of return on the equity investment in its affiliated-owned transportation services. The order further specified that the capital structure of the affiliate would be initially established in a separate hearing, with the appropriate return on equity for the affiliate to be a rate set equal to the midpoint of the utility's allowed range of return, whether set through a rate case, a stipulated agreement, or by Commission order.

One issue at hearing was what capital structure should be assumed for EFC in calculating the return component of the cost-plus arrangement for recovery as a prudent cost of fuel to FPC. We find that EFC's capital structure should assume an equity ratio of 55% of its net long term assets. In addition, we find that EFC's FPC-related operational costs should be compared to full regulatory treatment at least once a year.

Florida Power Corporation uses the "short cut" method to determine the appropriate earnings for EFC from FPC operations. This method is a surrogate for calculating the revenue requirements under traditional rate base regulation. The intent behind this methodology is to approximate the costs of the operations as though

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EFC were a part of FPC. This short cut methodology establishes a 55% equity to debt ratio, with equity and debt the only components included in the capital structure. As is the case for a regulated utility, deferred taxes and investment tax credits are not included in EFC's capital structure.

The investment base which earns a return consists only of net long-term assets. Thus, the working capital, which is normally included in a utility's rate base, is not included. While the short cut method implies that net long-term assets are supported only by debt and equity and working capital is supported by all other capital structure components, we find that long-term assets are also supported by deferred taxes and investment tax credits. We find that as long as positive working capital is greater than the deferred tax and investment tax balances, it appears that the ratepayers benefit from the exclusion of working capital and any additional capital structure components. This is because we have found that the short cut method produces lower costs to be passed on to the ratepayers. Nonetheless, there shall be an annual check of the short cut method against the full revenue requirements. If the results of this check show that it appears that the costs resulting from the short cut methodology appear unreasonable, we shall require an adjustment to the costs being passed on to FPC's ratepayers.

FPC states that the "equity component of EFC's capital structure used in calculating the return to which it is entitled, pursuant to Order No. 22401, should be comparable to the equity component of Florida Power's capital structure." (TR 11) The equity ratio is 55% percent of the long-term debt, common equity, and preferred stock. Preferred stock should be considered equity, although it has many characteristics of debt. If preferred stock and common equity are used as the numerator for the calculation, it shows that the equity ratio for FPC has been greater than 55% since 1986. However, while FPC has preferred stock, EFC has none. The Company has stated that EFC maintains the 55% equity ratio "purposely" in that "the amount of equity is controlled in order to produce the 55%." (TR 91)

OPC suggests that an adjustment should be made to EFC's equity ratio to reflect the reduced risk resulting from the return "guaranteed" to EFC as opposed to being given only the opportunity to earn a return. However, the record would not support such an adjustment.

We accept EFC's 55% equity ratio because it appears reasonable in light of FPC's equity ratio. However, if FPC's equity ratio is determined to be imprudent or becomes significantly lower, EFC's equity ratio shall be adjusted accordingly.

Another issue was whether the methodologies are appropriate to determine the Administrative and General (A&G) expenses incurred by EFC in the procurement of coal for FPC. Public Counsel took the position that there was no record basis for us to determine the appropriateness of EFC's methodologies for determining administrative and general expenses. However, written copies of the procedures used to allocate A&G expenses were distributed at hearing. During cross-examination concerning these procedures, we learned that FPC's internal auditors had verified that these written procedures were being followed, and that they were proper. In addition, as stated in the prehearing order, Staff has reviewed these procedures both in written form and in practice and they have also found them to be appropriate. We find that the manner in which EFC records direct charges and the manner in which it allocates those not directly chargeable appears to be appropriate and reasonable. Therefore, we find the methodologies used by EFC to determine administrative and general expenses applicable to FPC business to be appropriate.

Another issue was whether these Administrative and General expenses are reasonable. The A&G expenses included by EFC in the cost of coal to FPC are ultimately recovered by FPC from its ratepayers through the fuel adjustment proceedings. These proceedings give the Commission and other interested parties an on-going opportunity to review and question any costs believed to be unreasonable or imprudently incurred. We find that FPC continues to have the burden of proving that any A&G expenses included by EFC in FPC's cost of coal have been reasonably incurred, and that they have been allocated in accordance with approved methodologies.

The final issue heard at hearing was what amount of income tax expense should FPC be allowed to recover from its customers as a cost properly incurred by EFC in obtaining and delivering coal to FPC. We find that the amount of income tax expense included in FPC's cost of coal should be the income tax expense attributable to FPC business on a stand-alone basis for the reasons discussed below.

In computing the level of income tax expense to be included in FPC's cost of coal, EFC states that all revenues under the contracts between EFC and FPC for fuel supply are offset by all costs associated with the fulfillment of those contracts. EFC asserts that this computation uses "book," not "tax," revenue and

expense, and that it constitutes pre-tax income for this purpose. Once a pre-tax amount is determined, a tax expense is calculated based on the number as if it were the taxable income of a "stand-alone" corporate taxpayer. EFC also utilizes normalization when calculating income tax to be charged to FPC.

It appears that all parties agree that income tax expense should be included in the cost of fuel passed on to FPC. The method of calculating income tax expense is the real issue. EFC treats FPC business on a stand alone basis and calculates income taxes as if that portion of EFC's business were a separate tax-paying entity. However, OPC believes that FPC should not pay income taxes to EFC, if EFC, as a whole, does not have an actual tax liability.

OPC's witness stated that EFC was including a "hypothetical income tax cost" in the fuel cost charged to FPC even though there is no requirement in the contract that hypothetical expenses or cost be included in the cost plus charge for fuel supplies. However, FPC stated that EFC's allocation procedures for coal pricing to FPC, under coal supply and delivery agreements, specifically mentions that the allocation of income taxes will be included in the price computation for procuring and transporting coal to FPC. In addition, these allocation procedures clearly state that EFC separates its income and expenses between its regulated (FPC) activities and, those items generated or incurred as a result of its non-regulated (non-FPC) related activities.

Public Counsel also argues that the methodology used in determining the hypothetical income taxes to be included in fuel costs treats EFC as a utility when there is no basis to do so. However, the utility disagrees that there is no basis to treat EFC as if it were a utility. EFC calculates its income tax expense much like a utility does while a surrogate calculation of EFC's equity ratio produces results that are comparable to a regulated capital structure. EFC has also been subject to prudence determinations by us, like FPC. For these reasons, we find that EFC should be treated as if it were a utility.

Lastly, OPC argues that if it were correct to treat EFC as if it were a utility in determining a component of cost to be included in fuel charges, EFC has chosen certain applications of the ratemaking model which results in maximizing EFC's profits while increasing the fuel expense paid by FPC's ratepayers. The Company disagrees. Although EFC does not make regulatory adjustments such as parent debt, interest synchronization, or interest reconciliation, the "surrogate calculation" produces results that are comparable to a regulated capital structure. The Company looks

only at the long-term assets which are financed by long-term instruments. The Company then conducts a "sanity check" to make sure its use of long term assets produces the same or comparable answers to using a complete capital structure.

We find that the tax expense included in the cost of fuel to FPC is not hypothetical at all. There is an income tax expense associated with FPC business on a stand-alone basis. FPC does not receive any costs from the non-FPC, or non-regulated, transactions conducted by EFC, and it would be inappropriate to receive the benefit of any losses generated by the non-regulated activities of EFC. Accordingly, we find that the amount of income tax expense included in FPC's cost of coal should be the income tax expense attributable to FPC business on a stand-alone basis.

Finally, we find that this docket should be closed if no motion for reconsideration or appeal is timely filed.

It is, therefore,

ORDERED by the Florida Public Service Commission that Electric Fuel Corporation's capital structure should assume an equity ratio of 55% of its net long term assets. It is further

ORDERED that Electric Fuels Corporation's Florida Power Corporation related operational costs should be compared to full regulatory treatment at least once a year. It is further

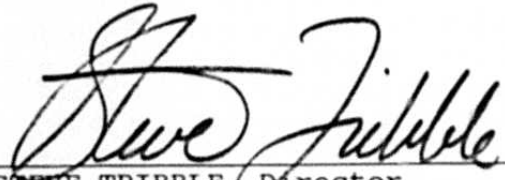
ORDERED that the methodologies used by Electric Fuels Corporation to allocate administrative and general expenses to Florida Power Corporation's cost of coal have been found to be appropriate and reasonable. It is further

ORDERED that the amount of income tax expense included in Florida Power Corporation's cost of coal should be the income tax expense attributable to Florida Power Corporation on a stand-alone basis. It is further

ORDERED that this docket shall be closed if no motion for reconsideration or appeal is timely filed.

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By ORDER of the Florida Public Service Commission, this 13th
day of May, 1992.



STEVE TRIBBLE, Director
Division of Records and Reporting

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NOTICE OF FURTHER PROCEEDINGS OR JUDICIAL REVIEW

The Florida Public Service Commission is required by Section 120.59(4), Florida Statutes, to notify parties of any administrative hearing or judicial review of Commission orders that is available under Sections 120.57 or 120.68, Florida Statutes, as well as the procedures and time limits that apply. This notice should not be construed to mean all requests for an administrative hearing or judicial review will be granted or result in the relief sought.

Any party adversely affected by the Commission's final action in this matter may request: 1) reconsideration of the decision by filing a motion for reconsideration with the Director, Division of Records and Reporting within fifteen (15) days of the issuance of this order in the form prescribed by Rule 25-22.060, Florida Administrative Code; or 2) judicial review by the Florida Supreme Court in the case of an electric, gas or telephone utility or the First District Court of Appeal in the case of a water or sewer utility by filing a notice of appeal with the Director, Division of Records and Reporting and filing a copy of the notice of appeal and the filing fee with the appropriate court. This filing must be completed within thirty (30) days after the issuance of this order, pursuant to Rule 9.110, Florida Rules of Civil Procedure. The notice of appeal must be in the form specified in Rule 9.900 (a), Florida Rules of Appellate Procedure.